SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Runner & Cardoza   Analyst: Marion Mann DeJong   Bill Number: AB 2461

Related Bills: See Prior Analysis   Telephone: 845-6979   Amended Date: 04/24/2000

Attorney: Patrick Kusiak   Sponsor:

SUBJECT: MIC/Change From 6% to 8% & Extend to Mineral Extraction & Certain Electric Power Generator Activities/Delete Repeal Date to Extend Indefinitely

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended __________.

_____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended __________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO __________________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 24, 2000, STILL APPLIES.

_____ OTHER - See comments below.

SUMMARY OF BILL

This bill would make the following changes to the Manufacturers' Investment Credit (MIC):

- increase the credit from 6% to 8% of qualified costs,
- extend the MIC to taxpayers engaged in extracting nonmetallic minerals,
- extend the MIC to specified taxpayers engaged in electric services,
- expand the current law definition of qualified activity to include extracting and generating of electricity,
- expand the definition of when manufacturing or other processes commence and conclude, and
- delete the repeal date.

SUMMARY OF AMENDMENT

The April 24, 2000, amendments made the following changes:

- modified the language that explicitly excludes equipment used in the extraction process from the definition of qualified property to include equipment used for specified extraction processes,
- removed an unlimited carryover provision and reinserted the current law limited carryover, and
- changed the operative date.

The April 24, 2000, amendments partially resolved the implementation consideration and resolved the technical considerations raised in the department's analysis of the bill as amended April 3, 2000.

Board Position:			Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Johnnie Lou Rosas	5/2/00
_____ N	_____ OUA	__X__ PENDING		

The information under "Legislative History" and the current law discussion under "Specific Findings" in the department's analysis of the bill as introduced February 24,2000, still apply. The remainder of the analysis of the bill as introduced and the analysis of the bill as amended April 3, 2000, is replaced with the following.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable or income years beginning on or after January 1, 2001.

SPECIFIC FINDINGS

This bill would increase the MIC from 6% to 8% of qualified costs.

This bill would add taxpayers engaged in extracting nonmetallic mineral activities and electric service activities to the definition of "qualified taxpayer." The extracting nonmetallic mineral activities are described in Standard Industrial Classification (SIC) Codes 1411 to 1499, inclusive, as follows:

- 141 DIMENSION STONE
  - 1411 Dimension Stone
- 142 CRUSHED AND BROKEN STONE, INCLUDING RIPRAP
  - 1422 Crushed and Broken Limestone
  - 1423 Crushed and Broken Granite
  - 1429 Crushed and Broken Stone, Not Elsewhere Classified
- 144 SAND AND GRAVEL
  - 1442 Construction Sand and Gravel
  - 1446 Industrial Sand
- 145 CLAY, CERAMIC AND REFRACTORY MINERALS
  - 1455 Kaolin and Ball Clay
  - 1459 Clay, Ceramic and Refractory Minerals, Not Elsewhere Classified
- 147 CHEMICAL AND FERTILIZER MINERAL MINING
  - 1474 Potash, Soda, and Borate Minerals
  - 1475 Phosphate Rock
  - 1479 Chemical and Fertilizer Mineral Mining, Not Elsewhere Classified
- 148 NONMETALLIC MINERALS SERVICES, EXCEPT FUELS
  - 1481 Nonmetallic Minerals Services, Except Fuels
- 149 MISCELLANEOUS NONMETALLIC MINERALS, EXCEPT FUELS
  - 1499 Miscellaneous Nonmetallic Minerals, Except Fuels

The electric service activities are described in SIC Code 4911 as establishments engaged in the generation, transmission, and/or distribution of electric energy for sale. Taxpayers holding a Certificate of Public Convenience and Necessity issued by the California Public Utilities Commission would not be qualified taxpayers for purposes of the MIC.

This bill would modify the definition of "qualified property" to include tangible personal property (IRC Section 1245(a) property) used by a qualified taxpayer in extracting nonmetallic mineral activities and electric service activities primarily for "extracting property" or "generation of electricity." This bill would further modify the existing law qualified activity definition within the qualified property rules by expanding the commencement point of the manufacturing or other process to include when raw materials are "obtained" within this process.

This bill, under the Personal Income Tax Law (PITL), also would modify the list of excluded property to include certain property used in the extraction process in the definition of qualified property. Specifically, equipment used for extraction processes described in SIC Codes 1400 to 1499, inclusive, would be considered qualified property.

This bill would remove the repeal date and the manufacturing employment evaluation from the MIC, extending the credit indefinitely.

Policy Considerations

This bill would raise the following policy considerations.

- When a general sales tax exemption for all manufacturing equipment proved too costly, the exemption was provided to only new manufacturers and the 6% MIC was enacted for other manufacturers as a partial offset against their sales and use tax paid with respect to manufacturing equipment. Moreover, the 1994 amendments to the MIC allowed taxpayers to claim the MIC with respect to their capitalized costs of direct labor, amounts upon which no sales or use tax is paid. An 8% tax credit would expand this benefit substantially beyond the general sales tax exemption originally considered.

- This bill would benefit transactions for which binding contracts already exist and would not be limited to benefit only future business decisions. Contracts entered into after January 1, 1994, but prior to enactment of this bill, already qualify for the credit, and existing binding contracts that require the payment of otherwise qualified costs under the MIC would qualify for the increased MIC benefit (additional 2%) provided under this bill.

- The bill would amend the qualified activity definition within the qualified property definition by expanding the "process" (manufacturing, processing, refining, etc.) to include "the point at which any raw materials are obtained." Because this change is not limited to the extractive activities added by this bill, it would allow existing qualified taxpayers to claim the MIC for equipment used to transport raw materials from the point that they are obtained (for example, a warehouse owned by the taxpayer) to the actual manufacturing, fabricating, etc., site. Under current law, such equipment would not qualify for the MIC because the MIC is limited to equipment use beginning at the point raw materials are "received." Further, if the term "obtained" were construed to mean the point at which title transfers, then a taxpayer that transported raw materials by trucks that it owned or leased, regardless of distance, would be entitled to claim the MIC for the costs of the trucks. Under current law the trucks would not qualify since they would not be treated as equipment used in the "process" qualifying the taxpayer for the MIC.

Implementation Considerations

- Although the April 24, 2000, amendments modified the exclusion of equipment used in the extraction process in the definition of qualified property under the PITL, this change was not made under the Bank and Corporation Tax Law (B&CTL). Amendment 1, provided at the author's request, would make the corresponding change to the B&CTL. Without this change, B&C could not claim the MIC for their extraction equipment.

- Under current law, the definition of qualified property includes tangible personal property used for specified activities, beginning with the point raw materials are added to the process and *ending at the point the activity has altered tangible personal property to its completed form, including packaging, if required*. This bill would add "extracting" to the list of activities that define the end of the "process."

  However, it is unclear whether extractive activities could ever result in the altering of tangible personal property to its completed form and thus the definition may not properly address extractive activities. This could result in some extractive industry taxpayers not being entitled to the MIC as intended by this bill. This could result in disputes between taxpayers and the department.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Extending the MIC to nonmetallic minerals and electric generators and increasing the credit from 6% to 8% would result in the following revenue losses:

Revenue Impact of AB 2461 Amended April 24, 2000 For Taxable/Income Years Beginning 1/1/2001 Assumed Enactment After 6/30/2000 Fiscal Years (In Millions)			
	2000-1	**2001-2**	**2002-3**
Increase MIC to 8%	-$21	-$91	-$137
Add Non-Metallic To MIC:			
Under Current Law @ 6%	-$1	-$3	-$5
Increase MIC to 8%	Minor	-$1	-$1
Add Elec. Gen. To MIC:			
Under Current Law @ 6%	-$2	-$10	-$16
Increase MIC to 8%	-$1	-$3	-$4
Total Change to MIC	**-$25**	**-$108**	**-$163**

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue losses decreased by $103 million for fiscal year 2000-01 and $48 million for 2001-02 and increased in fiscal year 2002-03 by $1 million from the prior estimate, primarily because the amendments changed the effective date from January 1, 2000, to January 1, 2001. In addition, the amendments deleted the provision extending the carryforward period indefinitely, thereby eliminating the projected revenue losses in the $5 million to $10 million range annually beginning in fiscal year 2008-09.

With the above exceptions, the previous analysis and assumptions for this bill still apply.

BOARD POSITION

Pending.

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Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2461
As Amended April 24, 2000

AMENDMENT 1

On page 21, modify line 38 as follows:

(D) Equipment used in the extraction process<u>, except equipment used for extraction processes described in SIC Codes 1400 to 1499, inclusive</u>.